No. 21,165

IN THE

United States Court of Appeals
For the Ninth Circuit

American Telephone and Telegraph Company, Security Savings and Loan Association and Victoria Savings and Loan Association, *Appellants,* vs. Federal Deposit Insurance Corporation, etc., et al., *Appellees.*	

REPLY BRIEF OF APPELLANT AMERICAN TELEPHONE AND TELEGRAPH COMPANY

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vs.	
FEDERAL DEPOSIT INSURANCE CORPORATION, etc., et al., *Appellees.*	

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PRELIMINARY STATEMENT

This reply brief is in response to the brief of appellee Federal Deposit Insurance Corporation (hereinafter called "FDIC") and the brief of appellees A.M.R., Inc., et al.

ARGUMENT

I. THE COMPLAINT STATES FACTS WHICH ENTITLE APPELLANT TO RESCISSION AND TO A CONSTRUCTIVE TRUST.

In our opening brief, we pointed out that appellant is entitled to rescission of its deposit or to the imposition

of a constructive trust on the assets of the Bank because of fraud of the Bank in accepting the renewal of appellant's deposit (Opening Brief, pp. 7-12). The complaint alleged that the Bank was known by its officers to be insolvent or in imminent danger of becoming insolvent and concealed that fact from appellant when it accepted renewal (R. 6). It also concealed the fact that it was paying illegal bounties to other depositors and that its officers were engaged in other illegal activities which imperiled its financial stability (R. 6).

Appellee FDIC seeks to support the dismissal of the action insofar as it involved a constructive trust or rescission on two grounds: (a) The complaint did not allege that the insolvency was "hopeless" or "irretrievable" (Brief of Appellee FDIC, pp. 8-11); and (b) the renewal of the deposit did not augment the assets of the Bank (Brief of Appellee FDIC, pp. 11-14). As we will show, there is no merit to either contention.

A. The complaint contains sufficient allegations of the insolvency of the Bank at the time it accepted the renewal of appellant's deposit.

A bank's insolvency at the time it accepts a deposit is grounds for rescission or imposition of a constructive trust. Contrary to FDIC's brief (Brief of Appellee FDIC, pp. 8-11), an allegation of "hopeless and irretrievable" insolvency is unnecessary.

Some cases, as cited by FDIC, do from time to time employ the "hopeless and irretrievable" rubric; other cases, however, speak only in terms of "insolvency," e.g., *Mechanics Co. v. Culhane* (1936) 299 U.S. 51, 57-58;

Richardson v. Olivier (5 Cir. 1900) 105 Fed. 277, 277-278; *Cronkleton v. Ebmeier* (8 Cir. 1930) 38 F.2d 748, 749-750.

The degree of insolvency existing at the time of deposit is a complex factual question not capable of determination by applying the oversimplified labels FDIC suggests to the Court. If such labels are essential to state a claim, appellant is entitled to amend its complaint. The conclusion of the Comptroller of the Currency that, by May of 1964 (8 months before the transaction in question), the Bank was "so murked down in rot and corruption that there was *no hope*"[1] affords ample basis for such an amendment.

Appellees A.M.R., Inc., et al., suggest that since the Bank was insolvent at the time it accepted the renewal of appellant's deposit, the repayment of the deposit would have constituted an unlawful preference (Brief of Appellees A.M.R., Inc., et al., p. 12). This line of argument has been flatly rejected by the Supreme Court (*McDonald, Receiver v. Chemical Nat'l Bank* (1899) 174 U.S. 610, 618; see also *Mechanics Co. v. Culhane* (1936) 299 U.S. 51, 56).

Apart from a bank's insolvency, a depositor is entitled to a constructive trust when other circumstances render it wrong or contrary to law or good conscience for the bank to accept his deposit (*Tucker v. Newcomb* (4 Cir. 1933) 67 F.2d 177, 179). Appellant contends that the Bank's solicitation and acceptance of the renewal of appel-

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[1]Quoted in Interim Report of Committee on Governmental Operations (U.S. Senate, 89th Cong., 2d Sess.), p. 40; emphasis added.

lant's deposit was wrongful, because the Bank concealed its perilous financial condition, the payment of illegal bounties to other depositors, and other illegal activities of its officers imperiling its financial stability (Opening Brief, pp. 8-9; see also R. 6).

Appellee FDIC cannot avoid the principle set forth in the *Tucker* case by the bald assertion that the *Tucker* case "is inapplicable factually" (Brief of Appellee FDIC, p. 15). Obviously, the circumstances which render an acceptance of a deposit wrongful will vary from case to case. Nor can FDIC avoid the *Tucker* principle by erroneously characterizing appellant's claim as resting solely on the Bank's insolvency (Brief of Appellee FDIC, p. 15).

B. Renewal of appellant's deposit augmented the assets of the Bank.

Appellee FDIC, by asserting (Brief of Appellee FDIC, p. 11) that appellant's renewal of deposit did not augment the assets of the Bank for purposes of a constructive trust, would require an actual, physical withdrawal and immediate redeposit of the funds on deposit in order for a depositor to preserve his rights. This ignores the fact that by the renewal of the deposit and the issuance of a new certificate of deposit the Bank obtained the right to use funds to which it otherwise would not be entitled. Also, it makes the result in any given case dependent on a totally unrealistic circumstance, i.e., whether the depositor was given physical possession of his deposit for a single instant at some stage in the renewal process.

Appellant has recognized that cases exist which reflect such a ritualistic approach to augmentation (Opening

Brief, p. 10). Cases cited by appellee FDIC (Brief of Appellee FDIC, p. 11) also reflect this approach but at the same time illustrate why it should not apply to this case. Both *Henneman v. Rosebud Bank* (Mo.App. 1935) 78 S.W. 2d 113 and *Barsness v. Tiegen* (1931) 184 Minn. 188, 238 N.W. 161 are based on erroneous legal assumptions. There the Missouri and Minnesota state courts erroneously assumed that an insolvent bank cannot lawfully repay deposits in the ordinary course of its business, and therefore those courts could not understand how, if the bank was insolvent at the time of the renewal, any augmentation could have occurred. Their assumption is directly contrary to the holding by the United States Supreme Court in *McDonald, Receiver v. Chemical Nat'l Bank* (1899) 174 U.S. 610, 618 (discussed above, p. 3).

Mallett v. Tunnicliffe (1931) 102 Fla. 809, 136 So. 346, *Venner v. Cox* (Tenn.Ch.App. 1895) 35 S.W. 769, and *Fagan v. Whidden* (5 Cir. 1932) 57 F.2d 631, did not involve renewals of deposits. In *Mallett* and *Venner,* the depositors intended to withdraw the funds in their bank accounts but were induced not to do so. In *Fagan,* the bank merely informed the depositor's executor that no deposit existed, thus enabling it to retain the depositor's savings account. These situations are fundamentally distinct from a depositor's renewal, at the express solicitation of the bank, of his deposit and the issuance of a new certificate of deposit issued for a specific length of time. In the cases cited by FDIC the banks maintained the status quo, but only until further demand by the depositors. In the case at bar, the renewal of the deposit and issuance of a new certificate of deposit gave the bank the

absolute right to the use of the funds for the additional term specified in the new certificate.

Luikart v. Schmidt (1940) 138 Neb. 282, 292 N.W. 723, is farther off the mark. The Nebraska Court was there concerned with enforcement of Nebraska's then existing statutory policy of shareholder liability in bank failures.

Allied Mills v. Horton (7 Cir. 1933) 65 F.2d 708, involved a mere breach of contract rather than fraud; also, the bank was not shown to have been insolvent at the time the check was deposited for collection (65 F.2d 711).

FDIC contends that appellant's cases, *Federal Reserve Bank v. Idaho Grimm Alfalfa Seed G. Ass'n* (9 Cir. 1925) 8 F.2d 922, 928, and *Am. Nat'l Bank v. Miller* (1913) 229 U.S. 517, 519-520, are inapplicable because they do not involve renewals of deposits (Brief of Appellee FDIC, pp. 15-16). FDIC ignores the substance of the transactions in those cases, which in economic effect were analogous to the renewal of a deposit.

Finally, FDIC's contentions as to augmentation are completely out of line with modern commercial practices. If its contentions are allowed to defeat appellant's claims, then bank depositors will in the future be required to engage in symbolic rituals (withdrawal and immediate redeposit) if they are to preserve their rights upon the renewal of a deposit and the issuance of a new certificate of deposit.

II. THE CLAIMS OF DEPOSITORS THAT RECEIVED ILLEGAL BOUNTIES SHOULD BE SUBORDINATED TO THE CLAIMS OF INNOCENT DEPOSITORS.

FDIC does not question that the bounties were illegal but asserts that appellant cannot rely upon that illegality to subordinate the claims of the bounty takers to those of the innocent depositors (Brief of Appellee FDIC, pp. 17-18). On the other hand, appellees A.M.R., Inc., et al.,[2] contend that the complaint does not show that the bounties were illegal (Brief of Appellees A.M.R., Inc., et al., pp. 13-20). Neither contention has merit.

FDIC apparently admits that payments received by depositors in the Bank in excess of the limits set by Regulation Q are illegal, but asserts (Brief of Appellee FDIC, p. 18) that no private cause of action accrues from such wrongdoing. Appellant however is not attempting to enforce Regulation Q against the Bank or against FDIC as its receiver. Appellant's claim involves only the rights of the creditors among themselves.

Blaney v. Florida National Bank at Orlando (5 Cir. 1966) 357 F.2d 27 (Brief of Appellee FDIC, p. 18) is inapplicable. In that case the plaintiffs, as holders of bonds issued under a trust indenture agreement, sued a national bank, as trustee, for violation of its fiduciary obligations. Plaintiffs attempted to state a Federal claim *against the bank* under a Federal Reserve regulation which requires a national bank to "conform to sound principles in the operation of its trust department" (357 F.2d 28). The court held that the plaintiffs could not sue

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[2]The reference by Appellees A.M.R., Inc., et al., to themselves as "the Majority Depositors," is without support in the record which does not show the aggregate amount of the claims against the Bank.

the bank under that regulation because the remedy *against the bank* for violations of the regulation belonged exclusively to the Board of Governors of the Federal Reserve System.

Appellant is not attempting to enforce Regulation Q against the Bank; rather appellant contends that the public policy against excessive interest payments expressed in Regulation Q and the equitable principles applicable to distribution of assets of an insolvent bank (Opening Brief, pp. 16-18) require subordination of the claims of the bounty-taking depositors.

Appellees A.M.R., Inc., et al., misstate appellant's complaint when they assert (Brief of Appellees A.M.R., Inc., et al., p. 3) it is based upon the depositor defendants' activities only in "link-financing" or "money-brokerage" transactions. On the contrary, the complaint alleges that the depositor defendants, "as compensation for making or renewing such deposits, and in addition to interest at legal rates * * * received directly or indirectly from Bank certain benefits, bounties or gratuities prohibited by law (hereinafter collectively called 'bounties')" (R. 4-5). Appellees' suggestion (Brief of Appellees A.M.R., Inc., et al., pp. 15-18) that they engaged only in assertedly lawful transactions is wholly unsupported by the record on this appeal, and cannot be maintained in the face of appellant's allegation of bounty taking, quoted above.

Appellees A.M.R., Inc., et al., assert (Brief of Appellees A.M.R., Inc., et al., p. 3) that the complaint is insufficient because it does not allege facts showing that taking bounties is illegal. The complaint meets the requirements of Rule 8(a) of the Federal Rules of Civil Procedure. It

alleges that the bounties received by these appellees were "prohibited by law" (R. 4-5), and that these bounties were "in addition to interest at legal rates" (R. 4).

In addition, FDIC argues that the equities require that the bounty takers be placed on the same footing as innocent depositors.[3] FDIC contends that if the bounty takers are subordinated, there would not be sufficient assets to pay any part of their claims (Brief of Appellee FDIC, p. 18). But there is no indication in the record that payment of the claims of the innocent depositors will exhaust the assets of the Bank or prevent a distribution to the bounty takers.

There is reason for subordinating the claims of the bounty takers. The facts controlling this appeal, alleged in appellant's complaint, are that "the payment of bounties contributed to the insolvency of Bank and to plaintiff's loss" (R. 9). It is noteworthy that FDIC informed the court below that bounty taking "contributed to the failure of San Francisco National Bank" (Closing Brief of FDIC in support of motion to dismiss in *A.M.R., Inc., et al. v. Federal Reserve Bank of San Francisco, et al.* (Civil Action No. 44387) p. 42; quoted, R. 142). This statement by FDIC was based largely on the findings contained in a report of the United States Senate Committee on Governmental Operations. That report states that "abuses asso-

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[3]FDIC, in its dual capacity as receiver of the Bank representing all creditors, and subrogee of the claims of the bounty-taking depositors to the extent it has paid them deposit insurance, is placed in the tenuous position of now defending the very practices which it previously attacked in *F.D.I.C. v. A.M.R., Inc., et al.* (U.S. District Court, N.D.Cal., Civil No. 43272). In that case, FDIC alleged that the receipt of bounties by depositors denied them the right to Federal deposit insurance.

ciated with certificates of deposit are principal factors in the chain of events that led to recent bank failures,'' and gives as an example ''San Francisco National Bank, which paid 7 percent for certain large amounts of funds obtained by certificates of deposit'' (Interim Report of Committee on Governmental Operations (U.S. Senate, 89th Cong., 2d Sess.) p. 6, see also ibid., pp. 8 and 31).

FDIC asserts (Brief of Appellee FDIC, p. 19) that if the claims of the bounty takers are subordinated, FDIC, as insurer and assignee of a portion of the bounty takers' claims, should be exempt from subordination. This assertion is unsupported by any authority, and ignores the fundamental principle that an assignee has no greater rights than his assignor (*Lount v. Mosher* (9 Cir. 1940) 115 F.2d 903, certiorari denied (1941) 313 U.S. 581). The same rule also applies where the assignee succeeds to the interest of the assignor under a contract of insurance (*Royal Indem. Co. v. Security Truck Lines* (1963) 212 Cal.App.2d 61, 65-66, 27 Cal.Rptr. 858, 860-861). This accords with section 11(g) of the Federal Deposit Insurance Act (64 Stat. 873, 885) which defines FDIC's subrogation rights as including the right ''to receive the same dividends from the proceeds of the assets of such closed bank * * * as would have been payable to the depositor * * *'' (64 Stat. 885; 12 U.S.C. 1821(g)).

CONCLUSION

For the foregoing reasons, we respectfully submit that this Court should reverse the orders dismissing the defendant depositors (which no appellee has attempted to support) and the order dismissing the action.

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Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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